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FINANCIAL DIGEST

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IS IT MORE SYMBOLISM . . .

Contrary to popular belief, the business outlook has not changed as a result of the Federal Reserve's hike in the discount rate from 12 percent to 13 percent. Nor, for that matter, can Federal Reserve monetary policy be said to have tightened. What the Fed did ten days ago is not all that different from what it did on Saturday, October 6, 1979, as well as on Wednesday, November 1, 1978. On those prior occasions, the discount rate was also boosted by one percentage point amid much fanfare that monetary policy had "tightened" and that the Fed was "determined" to fight the good fight against inflation.

This may yet come about—but if it does it will occur because of concrete steps taken in the money markets, rather than through the symbolism of a hike in the discount rate, or for that matter, public statements by Fed officials professing their "determination" to slow money supply growth in order to fight inflation. A look at the record provides evidence to support this assertion. For more than a year leading up to November, 1978, "L" (the Fed's new measure for total liquidity in the economy) was growing at an annual rate of about 12½ percent. By mid-year 1979, more than a half-year after the Fed's supposed policy change, "L" was still expanding at the same 12½ percent rate. This rate of growth prevailed right through October, 1979—the month in which Fed policy was supposed to have tightened again.

Other measures of credit availability tell essentially the same story. The growth rate of M3 has diminished by only two percentage points from the 11½ percent clip recorded in the 12 months ending November, 1978. M2 is actually growing faster today than it was in October, 1979, which in turn, represented a faster growth rate than that which prevailed in November, 1978. M1-B is growing at about the same pace that it has all the way through since November, 1978. M1-A, the narrowest version of the money and credit aggregates, is growing more slowly. However, as is well known by now, this slower rate of growth traces mostly to shifts in liquidity preferences by holders of currency and demand deposits because of rising interest rates.

. . . OR WILL MONEY FINALLY TIGHTEN?

The implication of these numbers is that increases in the discount rate and/or statements by Fed officials indicating a determination to tighten money to fight inflation are largely meaningless unless accompanied by concrete actions in the money markets. As long as the supply of money and credit in the economy continues to grow, Fed policy cannot be said to be tight. And if the Fed is not tight, then its chances of slowing the rate of inflation are pretty small, to say the least. In order to get a grip on the growth of money and credit, the Federal Reserve must conduct open-market operations in a way that slows the growth of bank reserves. To be sure, the latest 12-month growth rate for total bank reserves is down to 5½ percent from ten percent several months earlier and a high for the cycle of 14 percent reached at yearend 1978. If this trend continues, then the various money and credit aggregates will eventually grow more slowly. However, if they do so while the demand for funds remains strong, interest rates in the short-term markets will jump—and the Fed must be prepared to accept this as the price for gaining control over these aggregates.

In this respect, there is some hope. For in his testimony last week before the House Banking Finance and Urban Affairs Committee, Fed chairman Paul Volcker omitted any reference to avoiding a credit crunch. Rather, he said that the 1980 growth ranges established by the Federal Open Market Committee "would imply strong financial restraint" should inflationary pressures build more

(continued)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures – Millions of Dollars)

	Week Ending 2/13/80	Change Since Week Ago	Change Since Year Ago
Reserve Bank Credit:			
U.S. Gov'ts and Agencies Owned Outright & RPs	122,877	– 909	+11,009
Member Bank Borrowings	1,236	+ 477	+ 182
Float	4,968	– 94	– 1,465
Total Reserve Bank Credit	134,452	– 516	+ 9,411
Treasury Deposits with Federal Reserve Banks	3,727	+ 751	+ 582
Currency Outside Banks	109,995	+ 754	+11,870
Member Bank Reserves:			
Required	42,531	– 827	+ 1,951
Excess (Deficiency)	– 171	– 727	– 282
Total Reserves Held	42,360	–1,554	+ 1,669
Net Borrowed Reserves	1,316	+1,186	+ 483
Money Supply ($ Bil., SA) M1-A	376.2	– 0.8	+ 6.7%
Money Supply ($ Bil., SA) M1-B	392.8	– 0.3	+ 8.3%
		Change Since Month Ago	Change Since Year Ago
M2 ($ Bil., SA) (Jan. '80)	1,532.7	+ 8.8	9.0%
L ($ Bil., SA) (Nov. '79)	2,124.8	+ 9.4	11.3%

NEW YORK MONEY MARKET

Offering Rates 2/22/80	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	13.40%	13.40%	13.30%
*Federal Agencies	14.22	14.50	14.94
*Project Notes—Tax Free (46% Taxable Equivalent)	12.03	13.61	13.42
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	15.50	16.00	

‡Finance Company Paper—Prime

5- 14 days	13.75%
15- 29 days	14.00
30- 89 days	14.25
90-239 days	13.00
240-270 days	11.00

‡*Bankers' Acceptances

Mar.	14.00%
Apr.	14.00
May	14.30
June	14.30
July	14.10
Aug.	14.10

‡Industrial Paper—Prime

30- 89 days	14.00
90-120 days	14.20

†Federal Funds Effective Rate 14.35%

‡Discount Basis. *Subject to Availability. †Estimated.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'79n	$ 2,459	$ 2,397	$ 2,235
Gross National Product (1972 Dollars)*	4th Q'79n	$ 1,441	$ 1,433	$ 1,427
Percent Change, Annual Rate	4th Q'79n	2.1%	3.1%	5.6%
Change in Consumer Prices (all urban consumers)*	Jan. '80n	16.8%	14.4%	10.8%
Change in Producer Prices*	Jan. '80	19.2%	10.8%	14.4%
Civilian Employment (Thousands of Persons)†	Jan. '80	97,804	97,912	96,157
Unemployment as % of Civilian Labor Force†	Jan. '80	6.2%	5.9%	5.8%
Personal Income*	Jan. '80n	$ 2,036	$ 2,024	$ 1,818
Leading Indicators Composite Index (1967=100)†	Dec. '79	136.8	136.8	143.0
Industrial Production Index (1967=100)†	Jan. '80	152.7	152.3	151.5
Net Change in Consumer Instalment Credit†	Dec. '79	$ 1.55	$ 2.41	$ 4.40
U.S. Merchandise Trade Balance†	Dec. '79	–$ 3.08	–$ 1.42	–$ 1.75
Plant and Equipment Expenditures*	1st Q'80	$189.32(a)	$179.56	$165.94
Private Housing Starts (Thousands of Units)*	Jan. '80n	1,420	1,517	1,727
New Construction Expenditures*	Dec. '79	$ 239.6	$ 237.4	$ 223.2
Total Business Inventories†	Dec. '79	$ 426.3	$ 424.4	$ 379.6
Total Business Sales†	Dec. '79	$ 301.3	$ 299.3	$ 272.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

SHORT TERM PAPER OUTSTANDING
(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CDs Weekly Reporting Banks			
Nationwide (2/6/80)	92,671	+ 71	− 3,054
New York City (2/6/80)	20,243	− 73	− 8,601
Commercial Paper (2/6/80)	118,845	+1,175	+31,225

BANK LOANS
(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/6/80)	157,764	+1,134	+24,119
New York City (2/6/80)	47,779	+ 783	+ 9,425

	Total Loans Gross Adjusted Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/6/80)	397,487	+1,256	+53,837
New York City (2/6/80)	89,502	+ 130	+12,859

SECURITY MARKETS

	Friday 2/22/80	Change Since Week Ago	Change Since Year Ago
U. S. Governments, Closing Bid Prices:			
90-Day Bills (Discount Basis)	13.35%	+ .53	+ 3.91
180-Day Bills (Discount Basis)	13.35	+ .46	+ 3.80
Longest Bills (Discount Basis)	13.25	+ .88	+ 3.70
11½s 1/31/82	99.00	+1-27/32	
11⅞s 8/15/83	95.25	−2-30/32	
10½s 2/15/95	85.00	−3-10/32	
11¾s 1/15/10	94.00	−3-4/32	
Municipals:			
Bond Buyer—20 Bond Index* (2/21/80)	8.46%	+ .71	+ 2.08
Blue List Total ($ Million)	$ 651	−$ 84	−$ 141
30-Day Visible Supply ($ Million)	$1,919	−$ 457	−$ 81
Total	$2,570	−$ 541	−$ 222
Corporates:			
Moody's Aa Composite (2/21/80)	13.06%	+ .48	+ 3.55
Money Mgr.—30-Day Supply ($ Million)	$1,549	+$ 301	+$ 314
Stocks:			
Dow-Jones Averages			
Industrials	868.77	− 16.21	+ 45.49
Transportation	289.00	+ 1.80	+ 77.81
Utilities	110.93	− 0.27	+ 6.77
65 Stocks	318.55	− 2.65	+ 38.38
Standard and Poor's 500 Stocks	115.04	− 0.37	+ 17.26
N.Y.S.E. Composite Index	65.80	− 0.34	+ 10.92
N.Y.S.E. Avg. Daily Vol. for Week (000's)	46,068	− 7,886	+21,770

*46% Taxable Equivalent 15.67%

INTERNATIONAL RATES

	Friday 2/22/80	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	15.63%	14.00%
1 month	16.25	14.25
3 months	16.63	14.94
6 months	16.75	15.00
1 year	16.25	14.63
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	14.45%	12.81%
Long Term (10 to 15 yrs.)	14.65	13.42
FOREIGN EXCHANGE SPOT RATES New York Opening (in dollars)		
Belgium	.03500	.03539
Canada	.8703	.8623
France	.2426	.2451
Germany	.5689	.5754
Italy	.001232	.001242
Japan	.004051	.004105
Mexico	.04382	.04382
Netherlands	.5178	.5222
Switzerland	.6049	.6169
U.K.	2.2870	2.3060

strongly in the context of strengthening demand. He added: "Continued strong inflationary forces, accompanied by bulging credit demands, would tend to keep financial markets under strong pressure." Since sustained monetary restraint is not painless—as Fed chairman Volcker said, "it works, in part, by limiting the potential growth in nominal economic activity"—it will take every ounce of willpower that the Fed has to adhere to this course, especially in an election year.

BUDGET DEFICITS HAMPER FED POLICY . . .

As was pointed out several weeks ago (Financial Digest —February 4, 1980), the Federal government's budget deficit in the current fiscal year has been raised from an initial estimate of $29 billion to almost $40 billion. Adding in the demands of off-budget financing swells Washington's new cash needs to more than $56 billion.

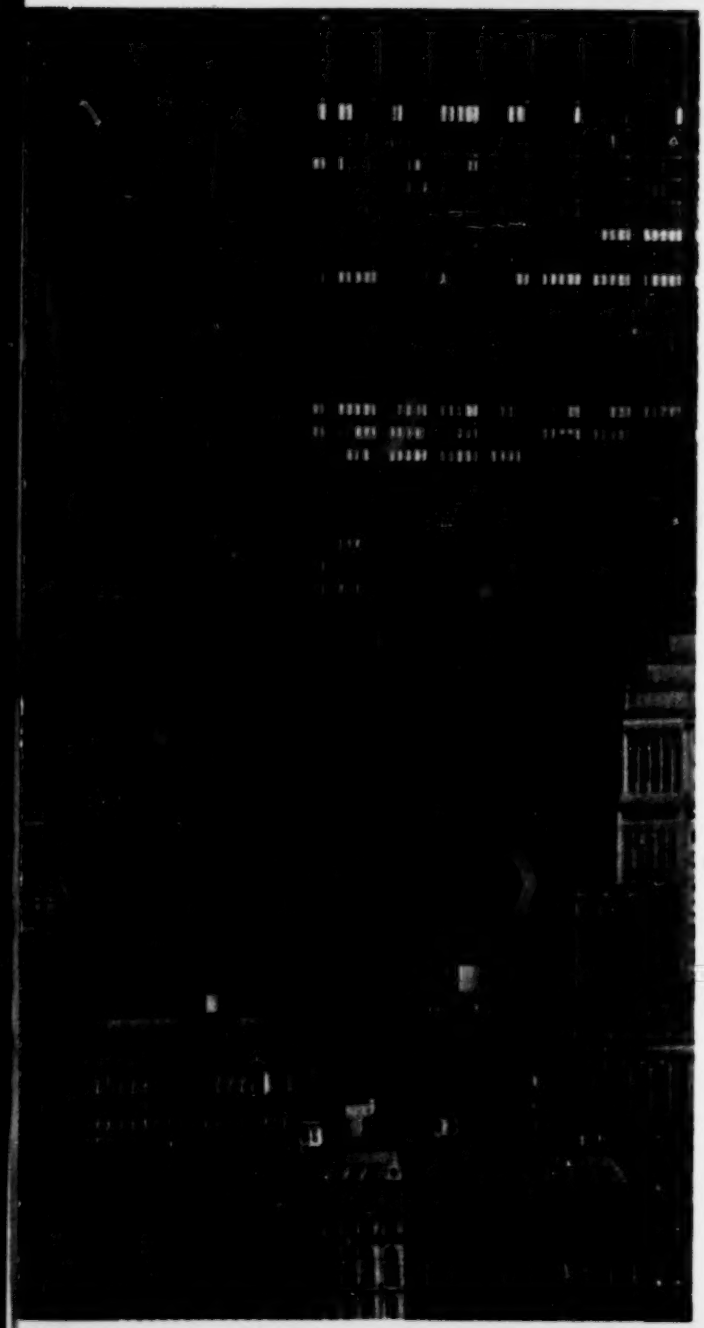
If this turns out to be an accurate measure of Washington's 1980 financing requirements, then any serious effort by the Fed to slow the growth of money and credit this year could mean sharply rising interest rates and, at times, a possible denial of funds to some politically sensitive sectors of the economy. The day that members of Congress and the Administration accept this and are willing to explain to the American people that everybody's belt must be tightened, not just "the other guy's," is the day that the Fed will turn the corner in its battle against inflation, and the long process of unwinding will begin.

Plainly, had the Federal Reserve conducted its open market operations the way it has conducted its open mouth policy since November, 1978, wholesale prices would not have risen at the 20 percent rate that they did in January. As Chairman Volcker said, "there is little doubt that inflation cannot persist in the long run unless it is accompanied by excessive expansion of money and credit." Wholesale prices would have gone up even faster last month had it not been for a drop in food prices, which fell 2.7 percent. Prices of finished goods other than foods jumped 2.4 percent in January—half again as fast as the overall producer price index. Not surprisingly, the rate of consumer price inflation appears to be getting worse. January's increase of 1.4 percent works out to a seasonally adjusted annual rate of about 17 percent—the largest one-month increase since August, 1973. Here, too, the overall advance was held back by food prices, which stabilized in the month.

. . . PRODUCING A SEARCH FOR SHORT CUTS

This kind of behavior of the price indexes has produced discussion of two distinctly different battle plans. Both are superficial methods of dealing with inflation—but both seem to have appeal since they offer short-run results. Going off in one direction—the path of living with inflation—are those who would "index" wages, prices, interest rates, etc. to the inflation rate. These people point to Brazil, where indexation is widespread. Almost all contracts have clauses that automatically adjust for price increases. Rents and mortgage payments are adjusted regularly to compensate for inflation as are most wages and salaries in the private sector and most types of spending by the public sector. Financial instruments ranging from savings accounts to corporate and government bonds pay a correction for inflation on top of the stated interest rate. This doesn't help inflation—if anything, it tends to worsen it, since most people have no stake in subduing inflation when they believe they are keeping up through indexation. The results can be seen in Brazil's inflation rate: 77 percent in 1979 versus 41 percent in 1978 and 35 percent in 1974.

Going the other way are those who would seek to slap on wage-price controls. Unlike indexation, this method appears to be gaining a growing number of adherents—including many respected economists. Such a policy may make the price indexes look good for a while, but it will not cure inflation any more than taking a thermometer from a patient with fever and plunging it into a glass of ice water can cure the person's illness. Advocates of controls say that they are merely responding to public demands. However, it is questionable whether the public really wants wage-price controls since it is questionable whether the public understands that controls would apply to everyone—not just to "the other guy."



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